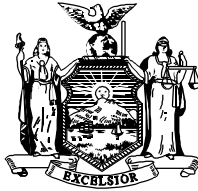


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January 25, 1999

Mr. Joseph Boardman
Commissioner
NYS Department of Transportation
State Office Building Campus - Building #5
Albany, NY 12232

Re: Report 98-F-44

Dear Commissioner Boardman:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have reviewed the actions taken by officials of the New York State Department of Transportation (DOT), as of November 30, 1998, to address the issues contained in our study report: *The Viability of the Oak Point Link and Harlem River Yard Projects* (Report 95-D-43). Our report, which was issued on February 5, 1997, studied the commercial viability of the Oak Point Link (Link) and the Harlem River Yard (Yard) as catalysts for restoring the rail freight industry in the downstate region of New York, as well as the propriety of the lease agreement between DOT and Harlem River Yard Ventures (HRYV).

Background

In the early 1970s, DOT, the Port Authority of New York and New Jersey, and the City of New York identified a series of capital improvements to improve the rail freight network in the downstate region of New York. These improvements comprised the Full Freight Access Program (Program), of which the two most important elements were the Link and the Yard.

In the early 1980s, DOT awarded contracts for construction of the Link and the development of the Yard, but the contracts were terminated in 1987, before the projects were completed. In 1991, DOT leased the Yard to HRYV and in the following year awarded a new contract for the completion of construction of the Link. According to DOT officials, about \$213 million in public funds have been expended altogether on the Link and the Yard, which were expected to provide the necessary intermodal freight services (transporting truck trailers and containers on rail cars) to New York City and Long Island and to help coordinate the fragmented

rail freight network in the region. Moreover, public officials estimated that the Link and Yard would reduce total shipping costs in the region by \$100 million per year, create more than 5,000 permanent jobs, reduce air pollution by reducing truck traffic on the region's highways, and help avoid \$500 million in public road improvement costs.

After our original study was issued, two major rail freight carriers (CSX and Norfolk Southern) merged and purchased Conrail operations, including those related to the use of the Link. At the time of our follow-up review, the merger's impact on the long-term future use of the Link and Yard was unclear.

Summary Conclusions

In our prior study, we found that the Link and the Yard may not be as commercially viable as originally projected because fewer customers may use the Yard than had been expected. In particular, the new double-stacked trains, which are the fastest-growing and most-economical mode of intermodal freight transportation, cannot access the downstate region because bridge clearances over the railroad tracks in and around the region are not high enough. Thus, the use of the Link and the Yard will be limited in the near future. This resulted, at least in part, because the responsible public and private entities did not have a plan for a comprehensive, coordinated, and economically-competitive rail freight system in the downstate New York region.

In addition, we questioned whether the 99-year lease of the Yard to a private developer is in the best interests of the State, as it appears that most of the economic benefits of the taxpayers' investment in the two projects will benefit the private developer, who had assumed little or no risk in the projects. Moreover, although the City of New York owed DOT \$10.7 million as of July 1996 for costs incurred during construction of the Link, DOT had not been able to collect any of these funds at the time of our original study.

Based on the results of our follow-up review, we determined that significant progress has been made on the Link and Yard. Specifically, construction of the Link has been completed; and development of the Yard, including construction of an intermodal transfer facility, has taken place. At the time of our follow-up review, construction of a waste transfer facility was underway at the Yard, and construction of a newspaper printing plant is planned. We also determined that DOT had collected about \$12.1 million from the City of New York for its share of the projects' costs (as of November 1998, DOT had billed the City of New York about \$14.3 million). However, there still is no plan for a comprehensive, coordinated, and economically-competitive rail freight system in the downstate New York region. In addition, it does not appear likely that the more than \$200 million in public funds invested in the Link and Yard projects will result in achievement of the major transportation or environmental goals planned for these projects.

Summary of Status of Prior Report Issues To Be Considered

Our prior report contained 11 issues to be considered. We found that four of these issues have been addressed by DOT; five others have been partially addressed; and the remaining two

have not been addressed.

Follow-up Observations

Issue To Be Considered 1

What actions need to be taken to develop a formal comprehensive long-term plan to produce a coordinated and economically viable rail freight network in the downstate region? Further, what leadership role should DOT take in facilitating the development of such a plan with the Port Authority and other rail freight entities?

Status - Issue Has Been Partially Addressed

Agency Action - Many rail freight feasibility studies of the New York City area have been performed in the past. However, these studies tended to focus on specific projects, instead of the broader matters of the New York City region. Moreover, there still is no formal, comprehensive, coordinated long-term plan to address freight movement by rail in the downstate region. DOT officials report that they are working with the New York City Economic Development Corporation (NYCEDC) in developing a rail plan for the region. Officials also told us that they will establish a rail council to advise DOT on railroad restructuring issues. Accordingly, they will develop a formal strategy for rail freight statewide that will encompass the Link and the Yard. This will include the potential use of the Link and Yard by the Canadian Pacific Railroad. DOT officials also indicated that the Governor's Office has established an interagency task force to address freight access in the New York metropolitan area.

Auditors' Comments - Based on discussions we had with NYCEDC officials, we conclude that NYCEDC is taking the leadership role in the development of a comprehensive rail freight plan for the downstate region. NYCEDC is currently identifying alternatives, through its Cross Harbor Freight Movement Major Investment Study, that can make the movement of goods throughout the New York City area more efficient. The study's goals include promoting economic development in the region through a more efficient system; the improvement of environmental quality in the region by diverting freight movements to less-polluting modes of transportation; and the fostering of an improved goods movement system into, out of, and through the region.

Although NYCEDC is taking the lead in rail freight planning, we believe that DOT still has a significant role to play in the process. DOT is responsible for the general oversight of transit operations within the State. This includes the coordination and development of policies and plans to provide adequate, safe, and efficient transportation facilities and services for rail freight at reasonable costs.

Issue To Be Considered 2

Should clearances on the rail lines between Selkirk and the downstate region be increased, and the significant corresponding costs incurred, so that modern rail freight equipment such as double-stacked and high-cube double-stacked trains can access the downstate region?

Status - Issue Has Not Been Addressed

Agency Action - DOT does not have a formal program or timetable specifically designed to raise bridge clearances over rail lines between Selkirk and the downstate region. DOT officials advised us that, based on a 1987 DOT policy, clearances will be raised to 20' 6" when each bridge is due for major repairs. According to DOT officials, clearances have been increased for the 3rd Avenue and Willis Avenue Bridges. However, DOT still has to raise clearances for about 40 more bridges to accommodate double-stacked trains. Officials previously advised us that it could take 30 years to raise the clearances for all of these bridges. Pursuant to our follow-up review, officials stated that the rail freight intermodal strategy they are currently formulating will include a process to review the 1987 clearance policy.

Auditors' Comments - In September 1998, a freight train conveying double-stacked containers was accidentally allowed to travel on the eastern portion of the Hudson River tracks used to transport freight. The train derailed when the double-stacked containers hit an overhead bridge, thus disrupting Metro-North's commuter operations for an entire day. Although this accident prompted and accelerated the recent opening of the Link, the low bridge clearances will likely limit the use of the Link and Yard for intermodal freight transportation well into the future. Thus, we continue to question the long-term commercial viability of the Link, given the increasing trend toward larger rail containers.

Issue To Be Considered 3

What steps need to be taken by DOT to ensure that an agreement with Conrail for the use of the Link is completed?

Status - Issue Has Been Addressed

Agency Action - A permit agreement between DOT and Conrail, effective October 11, 1998, allows Conrail to operate on the Link. As a result, Conrail now operates its daily downstate freight service over the Link (one early-morning southbound train from Selkirk to New York City and one evening northbound train from New York City to Selkirk).

Auditors' Comments - This limited use of the Link bears little resemblance to the vision outlined in the planning documents that justified the more than \$200-million public investment in the project. Furthermore, although freight trains no longer have to share the same tracks with commuter trains in the Bronx, the opening of the Link has not resulted in the projected increase in rail-freight traffic or cargo movement. As previously noted, there

is no indication that the acquisition of Conrail operations by CSX and Norfolk Southern will lead to increased use of the Link. Moreover, significant public investment in the intermodal facilities in Kearny, New Jersey, would tend to reduce the need to use the Link and the Yard.

Issue To Be Considered 4

What steps are being taken by DOT to collect the City's share of the Link's construction costs?

Status - Issue Has Been Addressed

Agency Action - NYCEDC, representing the City, began making payments in April 1997 after representatives from the State Comptroller's Office interceded with the New York City Corporation Counsel on behalf of DOT. Through November 1998, DOT billed the City of New York about \$14.3 million and NYCEDC has paid DOT about \$12.1 million. The last payment was made in January 1998 and, according to DOT officials, NYCEDC is not likely to pay a significant portion of the remaining unpaid claims because the agreement between the City and the State did not specifically require the City to reimburse DOT for certain personal services and real estate costs incurred to build the Link.

Auditors' Comments - We encourage DOT and NYCEDC officials to make concerted efforts to resolve the outstanding issues so that DOT can recover the City's proper share of the Link's construction costs.

Issue To Be Considered 5

What actions should DOT take to determine the availability of Intermodal Surface Transportation Efficiency Act (ISTEA) funding and to apply for such funding, if available?

Status - Issue Has Been Addressed

Agency Action - On behalf of HRYV, NYCEDC applied for ISTEA funds for the Yard in 1997. However, the Federal government did not approve the funding because the lease agreement between DOT and HRYV prohibited the use of ISTEA funds for the Yard. DOT representatives maintain that, although ISTEA funds were available for the Link, the funds were not requested because the Link was already fully-funded and construction was essentially complete when the ISTEA funds became available.

Auditors' Comments - The Transportation Efficiency Act (TEA 21), successor to ISTEA, includes a proposed allocation of \$173.1 million for rail-related projects in New York State, including funding for several intermodal projects. However, neither the Link nor the Yard is among the projects proposed for funding. We also note that no TEA 21 funds are allocated for projects to raise bridge clearances that could provide Link access for

trains with greater height requirements.

Issue To Be Considered 6

With more than \$200 million in public funds already spent or committed for the development of the Link and the Yard, how can DOT, senior public managers, and elected officials closely evaluate proposals to use additional public funds for these two projects, to ensure that such funding does not primarily benefit a private developer?

Status - Issue Has Been Partially Addressed

Agency Action - DOT officials stated that they do not have sole authority to propose or fund major projects. The Municipal Planning Organizations (MPOs), which include representatives from DOT and the Governor's Office, play a major role in this process. DOT's responsibility is to implement the plans of and projects approved by the MPOs and the Governor's Office. Officials further indicated that there are no plans at this time to allocate additional State funds to the Link or the Yard. DOT officials acknowledge that if additional public rail funds were to be invested in the Link and Yard, these investments would be reviewed in the context of obtaining public benefits and ensuring adequate private participation.

Auditors' Comments - Our study noted that the nearly \$220 million already spent on the Link and the Yard has primarily benefitted a private entity (HRYV) and the Metro-North Commuter Railroad. In addition, the Empire State Development Corporation (ESDC) will purchase the MTA bus garage (valued at \$8 million) and associated land adjacent to the Yard (valued at \$3.5 million) for \$11.5 million, conveying the property to HRYV for \$3.5 million, according to ESDC officials. Plans call for HRYV to lease the newly-acquired property and an adjacent section of the Yard to the New York Post, which will then build a new printing plant on the site. ESDC's contribution to this project helped HRYV to avoid \$8 million in costs that it would have incurred otherwise to acquire the MTA property.

Issue To Be Considered 7

Have adequate plans been developed to ensure that public funds spent to dredge the New York Harbor and to reopen the Howland Hook Terminal will complement public investment in the downstate rail freight system?

Status - Issue Has Been Partially Addressed

Agency Action - DOT officials stated that this is not solely a DOT issue, and that they are cooperating and participating with the Port Authority and NYCEDC in evaluating the various options for dredging the New York Harbor. Further, as noted previously, the NYCEDC is identifying alternatives, through its Cross Harbor Freight Movement Major Investment Study, to make the movement of goods throughout the New York City area

more efficient.

Auditors' Comments - Although the NYCEDC is studying freight matters in the New York City area, DOT officials should be aware that plans to dredge the New York Harbor and efforts to reopen the Howland Hook Terminal may have great impact on other State-funded projects. Moreover, this situation demonstrates the need for better regional planning regarding freight rail operations in the New York City area. If projects such as the dredging of the Harbor and the opening of Howland Hook Terminal further abrogate the need for the Link and Yard, State officials should question whether it is appropriate to commit additional public funding to develop the Yard and related projects, including the purchase and sale of the MTA bus garage and associated land.

Issue To Be Considered 8

What actions should be taken by DOT if economic development of the Yard does not occur, as prescribed by the lease agreement? Should such actions include:

- *renegotiation of specific lease terms, such as the 99-year lease term and DOT's share of gross rental revenues?*
- *providing Ventures [HRYV] with a notice of default for non-compliance with the lease agreement and develop the Yard themselves?*

Status - Issue Has Been Addressed

Agency Action - Significant progress has been made with respect to the economic development projects for the Yard. Specifically, the intermodal freight terminal is now complete and HRYV has begun construction at the Yard. Completion of a \$20-million waste transfer station is projected for the spring of 1999. In addition, the New York Post is expected to construct a \$250-million printing plant on the MTA bus garage site. There also is a proposal to build a paper recycling plant within the Yard.

Auditors' Comments - The significant progress that has been made on the economic development projects in the Yard should be viewed positively. However, it should be noted that the waste transfer and printing projects have little relationship to rail freight. Furthermore, such projects will not yield the environmental benefits that were projected when DOT leased the Yard to HRYV.

Issue To Be Considered 9

Would increased oversight of operations at the Yard ensure that DOT is receiving its fair share of revenues and that Ventures' [HRYV's] expenditures are not overstated?

Status - Issue Has Been Partially Addressed

Agency Action - DOT's oversight, provided since February 1998 by its New York City regional office, has consisted of twice-a-week visits to the Yard to check on construction activity and to ensure that HRYV is following the Land Use Plan (part of DOT's lease agreement with HRYV). DOT staff has also used the visits to help ensure that expenses claimed by HRYV are justified. However, DOT has not reviewed HRYV records to ensure that DOT is receiving its fair share of revenues. In fact, HRYV stopped sending quarterly financial statements to DOT after March 31, 1997.

Auditors' Comments - Although construction of all projects at the Yard is not yet complete and intermodal operations have not yet begun, HRYV has earned revenues from limited parking and waste-transfer operations. The contract with DOT prescribes that HRYV pay 6 percent of such revenues (less costs to clean up hazardous wastes) to DOT. Furthermore, beginning in October 1998, the contract requires HRYV to pay the State the greater of 6 percent of gross operating revenues or \$400,000 annually for use of the Yard. The first payment under this provision is due on January 30, 1999. Pursuant to the lease agreement, DOT has authority to review HRYV's records. To ensure that the State is being credited with its proper share of revenues, DOT should perform periodic reviews of the operations and fiscal records of HRYV.

Issue To Be Considered 10

What action is DOT taking to ensure that the marketing fund is established, used, and monitored?

Status - Issue Has Not Been Addressed

Agency Action - The lease agreement requires HRYV to establish a \$100,000 marketing fund to promote rail transportation at the Yard. The agreement further provided that DOT and HRYV jointly manage the fund. However, in September 1998, DOT officials told us that HRYV has not established the marketing fund. DOT officials further stated that they would formally communicate with HRYV on this matter. In a letter dated December 23, 1998, DOT's Counsel asked HRYV to provide DOT with information regarding the marketing fund and how it had been used to date.

Auditors' Comments - Although HRYV has not formally established a marketing fund, an HRYV official told us that HRYV has incurred some costs to advertise the Link and the Yard. Moreover, the HRYV official indicated that the key to promoting the two projects is not advertising. Instead, he said, the railroads (Conrail, CSX, and Norfolk Southern) should actively try to convince their customers to use the facilities. The official added that HRYV is attempting to work with the railroads to jointly hire a consultant who could help market the projects.

We concluded that DOT should make an effort, more effectively than it had done before our follow-up review, to ensure that HRYV complies with agreement provisions to market

the Link and Yard. If DOT officials determine that HRYV officials are not complying with such provisions, they should initiate actions to obtain compliance by HRYV. Such actions could include requiring HRYV to establish an escrow account that will ensure the availability of sufficient funds for the marketing fund.

Issue To Be Considered 11

Why has the conflict between Waste Management Inc. and Ventures [HRVY] not been resolved? Is the effect of denying Waste Management, Inc. access to rail facilities to increase waste collection costs in New York City? Would resolution ensure that the objectives of the Program are achieved?

Status - Issue Has Been Partially Addressed

Agency Action - Waste Management Inc. merged with USA Waste, Inc. The new entity, Waste Management, Inc., is building the waste transfer station at the Yard.

Auditors' Comments - As part of the merger agreement, Waste Management, Inc. was required to sell three of the ten waste transfer stations it operates in New York City, including the plant that is adjacent to the Yard. Representatives at this plant, who noted that they still will not have access to the Yard when the sale is completed, told us that they currently truck about 80 truck loads of trash daily to Conrail's nearby Oak Point Yard. They further stated that rail access to the Yard would serve the City's waste removal needs more effectively. Furthermore, such access would seem to be consistent with the desire to reduce the air pollution and wear on roads caused by large trucks.

Major contributors to this report were Gerald Tysiak, Brian Mason, Santo Rendon, Kenrick Sifontes, and Tammy Dunn.

We would appreciate your written response to this report within 30 days, indicating any additional actions planned or taken. We also thank the management and staff of the Department of Transportation for the courtesies and cooperation extended to our staff during this review.

Very truly yours,

Frank J. Houston
Audit Director

cc: Robert L. King